

AF INANCIAL STATEMENT AUDIT

California Children and Families Commission
Children and Families Trust Fund
and Related Accounts
For the Fiscal Year Ended
June 30, 2005

Prepared By:
Office of State Audits and Evaluations
Department of Finance



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

October 14, 2005

Ms. Kris Perry, Executive Director
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

Dear Ms. Perry:

Final Audit Report on the Children and Families Trust Fund and Related Accounts

Enclosed is the final report on our financial audit of the Children and Families Trust Fund and related accounts, for the fiscal year ended June 30, 2005. Our audit was performed under interagency agreement number CCFC-6977, between the California Children and Families Commission and the California Department of Finance.

The enclosed report is for your information and use. The response to the Finding and Recommendation is included herein. We believe the recommendation included in this report will help the Commission improve fiscal accountability.

If you have any questions regarding this report, please contact Mary Kelly, Manager, or Kiran Rai, Supervisor, at (916) 322-2985.

Sincerely,


Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Bryan Hobson, Chief, Administrative Division, California Children and Families Commission

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PREFACE

The Department of Finance, Office of State Audits and Evaluations, performed this audit under Health and Safety Code Section 130150. The purpose was to audit the *Balance Sheet* and *Statement of Operations* of the Children and Families Trust Fund and related accounts (Fund) for the fiscal year ended June 30, 2005.

The financial audit objectives were to:

- Express an opinion on the financial statements based on our audit, conducted in accordance with standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.
- Verify that the financial statements were prepared in conformity with the accounting practices as prescribed by the State of California, which is a comprehensive basis of accounting other than generally accepted accounting principles.
- As necessary, report on internal control over financial reporting weaknesses, as well as noncompliance with applicable laws and regulations.

This report is intended solely for the information and use of the California Children and Families Commission and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited. Requests for copies should be made to the California Children and Families Commission.

STAFF:

Mary Kelly, CPA
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DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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INDEPENDENT AUDITOR'S REPORT

Ms. Kris Perry, Executive Director
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

We have audited the accompanying *Balance Sheet* as of June 30, 2005, and the related *Statement of Operations* of the Children and Families Trust Fund and related accounts (Fund) for the fiscal year then ended. These financial statements are the responsibility of the California Children and Families Commission's (Commission) management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with *Government Auditing Standards (GAS)*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide reasonable assurance as to whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management. We believe that our audit provides a reasonable basis for our opinion.

In connection with our audit, there are certain disclosures required by GAS Statement No. 3. Both the audited entity and the Department of Finance, of which the Office of State Audits and Evaluations is a unit, are part of the State of California's Executive Branch, which GAS considers an impairment of independence. Also, as required by various statutes within the California Government Code, the Department of Finance's other units are mandated to perform certain management and accounting functions. These activities impair independence. Although the Department of Finance is statutorily obligated to perform these specific activities, we believe that sufficient safeguards and divisions of responsibility exist that would enable the reader of this report to rely on the information contained therein.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2005, and the results of the Commission's operations for the fiscal year then ended, in conformity with the basis of accounting described in Note 2 to the financial statements.

Compliance

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a


direct and material effect on the determination of statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide assurance on internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition. A reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. This reportable condition is described in the *Finding and Recommendation* section of this report.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not disclose all reportable conditions that are also considered to be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Commission and the Legislature, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.



Richard R. Sierra, CPA
Manager, Office of State Audits and Evaluations
(916) 322-2985

September 30, 2005

BALANCE SHEET

California Children and Families Commission Balance Sheet At June 30, 2005

	Children and Families Trust Fund (0923)	Counties Children and Families Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Assets								
Cash	\$ 14,528,932	\$ 772	\$ 991,846	\$ 64	\$ 945	\$ 645	\$ 33,264	\$ 19
Deposits in SMIF	39,366,000	40,831,000	43,666,000	105,628,000	59,441,000	68,208,000	20,262,000	29,441,000
Receivables	40,143,673	0	46,501	0	812,768	0	1,464	0
Due from Other Funds	1,155,091	76,253,034	5,985,883	6,772,664	3,285,572	3,334,777	1,093,627	2,250,274
Due from Other Governments	0	0	0	0	0	0	0	0
Advances and Loans Receivable	0	0	0	0	0	0	2,079	0
Prepaid Expense	0	0	0	0	0	0	40,000	0
Total Assets	\$ 95,193,696	\$ 117,084,806	\$ 50,690,230	\$ 112,400,728	\$ 63,540,285	\$ 71,543,422	\$ 21,432,434	\$ 31,691,293
Liabilities								
Accounts Payables	\$ 0	\$ 39,835,140	\$ 2,089,512	\$ 1,769,957	\$ 1,813,790	\$ 1,933,471	\$ 35,717	\$ 684,922
Due to Other Funds	95,193,696	3,439	24,263	263,932	33,968	265,428	41,572	2,537,891
Due to Other Governments	0	77,246,227	0	601,000	4,192,236	124,269	31,415	397,126
Total Liabilities	\$ 95,193,696	\$ 117,084,806	\$ 2,113,775	\$ 2,634,889	\$ 6,039,994	\$ 2,323,168	\$ 108,704	\$ 3,619,939
Fund Balance								
Reserved for Encumbrances	0	0	20,458,287	36,418,822	22,849,526	23,601,650	69,976	13,239,072
Reserved for Unencumbered Balances of Continuing Appropriations	0	0	28,118,168	73,347,017	34,650,765	45,618,604	21,253,754	14,832,282
Total Fund Balance (Deficit)	0	0	48,576,455	109,765,839	57,500,291	69,220,254	21,323,730	28,071,354
Total Liabilities and Fund Balance	\$ 95,193,696	\$ 117,084,806	\$ 50,690,230	\$ 112,400,728	\$ 63,540,285	\$ 71,543,422	\$ 21,432,434	\$ 31,691,293

The accompanying notes are an integral part of the financial statements.

STATEMENT OF OPERATIONS

California Children and Families Commission Statement of Operations For the Fiscal Year Ended June 30, 2005

	Children and Families Trust Fund (0623)	Counties Children and Families Account (0585)	Mass Media Communications Account (0631)	Education Account (0634)	Child Care Account (0636)	Research and Development Account (0637)	Administration Account (0638)	Unallocated Account (0639)
Fund Balance July 1, 2004	\$ 0	\$ 8,510,775	\$ 38,356,392	\$ 92,454,894	\$ 59,877,221	\$ 70,623,590	\$ 18,838,421	\$ 29,316,759
Additions								
Cigarette Tax Revenue	620,006,895	0	0	0	0	0	0	0
SMIF Interest Revenue	1,119,574	462,986	817,879	2,154,216	1,324,684	1,516,660	423,159	565,898
Other Revenue	0	0	0	4,170,375	0	0	0	0
Transfers from Other Funds	0	477,046,998	35,778,525	29,815,437	17,889,262	17,889,262	5,963,087	11,926,175
Total Additions	621,126,469	477,509,984	36,596,404	36,140,028	19,213,946	19,405,922	6,386,246	12,492,073
Deductions								
Appropriation Expenditures	3,517,722	486,020,759	26,376,341	18,829,083	21,590,876	20,809,258	3,900,937	13,737,478
Transfers to Other Funds	617,608,747	0	0	0	0	0	0	0
Total Deductions	621,126,469	486,020,759	26,376,341	18,829,083	21,590,876	20,809,258	3,900,937	13,737,478
Fund Balance June 30, 2005	\$ 0	\$ 0	\$ 48,576,455	\$ 109,765,839	\$ 57,500,291	\$ 69,220,254	\$ 21,323,730	\$ 28,071,354

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

California Children and Families Commission Children and Families Trust Fund and Related Accounts For the Fiscal Year Ended June 30, 2005

NOTE 1 **Definition of Reporting Entity**

The Children and Families Trust Fund (Fund) and its related accounts were created by the California Children and Families Act of 1998 (Act). Subsequent to the Act, legislation passed that provided for the Children and Families Commission to be known as "First 5 California." The Act is intended to promote, support, and improve the early development of children from the prenatal stage to five years of age. The programs authorized by this Act are administered by the California Children and Families Commission (Commission) and by county Children and Families Commissions.

Effective January 1, 1999, Section 30131.2 of the Revenue and Taxation Code authorized the State Board of Equalization (Board) to collect 87 cents for each cigarette pack distributed and a surtax on other tobacco products. Of the 87 cents collected, 50 cents is allocated and deposited into the Fund.

The Fund was established to provide funding for research and development, education, training, and other functions specified in the Act. However, it primarily functions as a pass-through account with monies used to pay Board administrative costs and to transfer the remaining amount to its related accounts according to allocation percentages established by the Act. The county commissions receive 80 percent of the funding and the Commission receives 20 percent, which is allocated to 6 separate accounts, as illustrated in the following table.

Fund/Account	Tax Revenue Allocation	Fund Purpose
Counties Children and Families Account (0585)	80%	This account is established for the 80 percent of the funds received in the California Children and Families Trust Fund (0623) to be allocated and appropriated to county commissions and expended for the purposes authorized in accordance with each county's strategic plan.
Mass Media Communications Account (0631)	6%	To provide funding for communications to the general public utilizing television, radio, newspapers, and other mass media furthering the goals and purposes specified in the <i>California Children and Families Act of 1998</i> .
Education Account (0634)	5%	To provide funding for education goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Child Care Account (0636)	3%	To provide funding for child care goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Research and Development Account (0637)	3%	To provide funding for research and development goals and purposes as specified in the <i>California Children and Families Act of 1998</i> .
Administration Account (0638)	1%	To provide funding for administrative costs and other purposes as specified in the <i>California Children and Families Act of 1998</i> .
Unallocated Account (0639)	2%	To provide funding for any other purposes of the <i>California Children and Families Act of 1998</i> , except that no expenditures for administrative costs may be made from this account.

Each county commission receives a portion of the monies equal to the percentage of the number of live births recorded in the relevant county (for the most recent reporting period) in proportion to the entire number of live births recorded in California (for the same period). Vital statistics compiled by the Department of Health Services are used. All fund expenditures must be incurred in accordance with the provisions of the Health and Safety Code Section 130105 (d).

NOTE 2 Summary of Significant Accounting Policies

a. Basis of Presentation

The Children and Families Trust Fund (Fund) and related fund accounts are classified as *Other Governmental Cost Funds* for State of California financial reporting purposes. *Other Governmental Cost Funds* are special revenue funds used to account for revenues restricted by law for specified purposes.

b. Measurement Focus and Basis of Accounting

The accounting method used for the Fund's financial accounting and reporting purposes is in compliance with the accounting policies and procedures prescribed by the California State Administrative Manual and the California Government Code, which is a comprehensive basis of accounting other than generally accepted accounting principles (GAAP). This method is consistent with the modified accrual basis of accounting, whereby revenues are recorded when they become measurable and available, and expenditures are recorded when the related liability is incurred.

c. Revenue

Revenues consist of the cigarette taxes collected on sales of cigarette packs and other tobacco products, interest income earned on funds deposited in the Surplus Money Investment Fund (SMIF), revenue from the sale of educational materials, and unclaimed checks escheated to the issuing fund.

d. Expenditures

Expenditures are recognized when the related liability is incurred or when monies are transferred to the State Payroll Revolving Fund for the payment of salaries, wages, and benefits.

e. Cash and Pooled Investments

Cash is deposited in the state's centralized treasury system, which combines the balances of state agencies into a single bank account to simplify cash management. Idle Fund cash is invested in the state's Surplus Money Investment Fund (SMIF). SMIF is a pooled investment account managed by the Pooled Money Investment Board. Each fund whose monies are deposited in this pooled investment account has an equity share in the balance, with investment income allocated to participants based on relative equity at month end.

f. Due To/From Other Funds

The "Due to Other Funds" account for the Fund represents the cigarette tax revenues due to the other seven related accounts as described in Note 1. Additionally, the "Due to Other Funds" account for the other 6 accounts represents allocations due to the Unallocated Fund 0639 for the School Readiness Program administered by the Commission. Under this Program, the Commission distributes funds to eligible counties, in addition to the required 80 percent allocation of cigarette taxes as provided in Note 1, to assist with the development of children ages 0 through 5 to ready them for school.

The "Due from Other Funds" account represents the amounts due from the Fund for the cigarette tax revenue allocations and SMIF interest.

g. Interfund Transfers

Legally authorized transfers between state funds are reported on the *Statement of Operations* as "Transfers from Other Funds" or "Transfers to Other Funds," and are accounted for as additions to or deductions from fund balance.

"Transfers to Other Funds" represents the sum of the statutorily required backfill of \$21,300,000 and the "Transfers from Other Funds." The "Transfers from Other Funds" are calculated based on the applicable percentage of the Fund revenues, which include cigarette taxes and SMIF interest income.

The Health and Safety Code Section 130105 requires the backfill of lost funding for certain Proposition 99 and Breast Cancer Fund programs. Specifically, the Code provides that "the State Board of Equalization shall determine within one year of the passage of this act the effect that additional taxes imposed on cigarettes and tobacco products by this act has on the consumption of cigarettes and tobacco products in this state. To the extent that a decrease in consumption is determined by the State Board of Equalization to be the direct result of additional taxes imposed by this act, the State Board of Equalization shall determine the fiscal effect the decrease in consumption has on the funding of any Proposition 99 (the Tobacco Tax and Health Protection Act of 1988) state health-related education or research programs in effect as of November 1, 1998, and the Breast Cancer Fund programs that are funded by excise taxes on cigarettes and tobacco products. Funds shall be transferred from the California Children and Families Trust Fund to those affected programs as necessary to offset the revenue decrease directly resulting from the imposition of additional taxes by this act. Such reimbursements shall occur, and at such times, as determined necessary to further the intent of this subdivision."

h. Retirement Plan

Employees of the Commission are members of the California Public Employees' Retirement System (CalPERS), which is a defined benefit contributory retirement plan. Retirement contributions by employees are set by statute as a percentage of payroll (Tier I employees), or are zero (Tier II employees). Retirement contributions are actuarially determined under a program where total contributions plus CalPERS' investment earnings will provide the necessary funds to pay retirement benefits when incurred. The employer contributions are included in the cost of personal services. For further information, refer to the annual single audit of the State of California, and to the CalPERS Comprehensive Annual Financial Report.

i. Vacation and Sick Leave

Under the state's accounting guidelines, the costs of vacation and sick leave are not recorded at the time the benefits are earned, but rather when incurred. When leave is used, the personal services expenses account is

charged. Under GAAP, the accumulation of employees' vacation and sick leave credits is accounted as a liability to be charged when the credits are used.

NOTE 3 Budgeting and Budgetary Control

The Funds are classified as *Other Governmental Cost Funds* for budgetary purposes. An *Other Governmental Cost Fund* is used to account for revenues from taxes, licenses, and fees where the use of such revenues is restricted by law for particular functions or activities of government. Program funds are continuously appropriated without regard to fiscal year.

Commission management is responsible for exercising budgetary control to ensure that appropriations are not overspent at the fund level. The State Controller's Office is responsible for statewide appropriation control and does not allow expenditures in excess of authorized appropriations.

NOTE 4 Fund Balance

The term *fund balance* is defined as the excess of the assets of a fund over its liabilities. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balance that are legally segregated for specific uses.

Reserved for Encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.

Reserved for Unencumbered Balances of Continuing Appropriations represents the unencumbered balances of all appropriations for which the period of availability extends beyond the period covered by this report. These appropriations are legally segregated for a specific future use.

FINDING AND RECOMMENDATION

During our audit of the California Children and Families Commission's (Commission) Children and Families Trust Fund and related accounts, we noted certain matters concerning the accounting and administrative controls that we consider to be a reportable condition. If left uncorrected, this condition could compromise the accuracy of the Commission's financial statements.

FINDING

Monitoring of Accrued Expenditures Needs Improvement

Condition:

The Commission does not maintain adequate internal records for fiscal monitoring purposes. Specifically, the Commission does not reconcile the year-end CALSTARS D16 report (Payables and Encumbrances) to its internal documents, and may be unable to ensure the completeness and accuracy of the year-end balances.

In two of seven payables tested, the amounts reported on the D16 report for year-end accounts payable did not agree to expenditures incurred. One transaction for Fund 0634 (Education) was overstated by \$701,641. Another transaction was recorded for Fund 0631 (Mass Media) in fiscal year 2003-04 and not reversed. This resulted in overstated accounts payable of \$385,344 at June 30, 2005.

In addition, the "Due to Other Funds" account for Fund 0634 (Education) is overstated by \$804,382. The respective transaction was recorded for fiscal year 2003-04 and not reversed.

The Commission has a fiduciary responsibility for ensuring the accuracy of its records. The quality of system-generated information affects management's ability to control activities, make appropriate decisions, and prepare reliable financial reports. Without ongoing monitoring, reconciliation, and document retention the potential for undetected errors or irregularities increases.

The errors were subsequently corrected on the financial statements, but only after they were identified by the auditors. This is a recurring condition from a prior audit.

Criteria:

The State Administrative Manual (SAM) Section 7920 states that each agency is responsible to complete any reconciliation necessary to safeguard the state's assets and ensure reliable financial data.

SAM Sections 7221 and 20050 require supporting documentation as the basis for recording transactions, and that adequate internal accounting controls are in place to safeguard assets and assure the reliability of accounting data.

Recommendation: Prepare a year-end reconciliation of internal records and the CALSTARS D16 report. The reconciliation process should include working closely with the Department of General Services' Contracted Fiscal Services to ensure that the reconciliation is correct and complete, and that any required adjustments are timely and properly recorded.

COMMISSION'S RESPONSE



MEMORANDUM

DATE: October 11, 2005

TO: Samuel E. Hull, Chief
Office of State Audits and Evaluations
Department of Finance
915 L Street
Sacramento, CA 95814

FROM: Kris Perry, Executive Director *Kris Perry*
California Children and Families Commission
501 J Street, Suite 530
Sacramento, CA 95814

SUBJECT: RESPONSE TO FINDINGS – CCFC FISCAL AUDIT FOR FY 04/05

The California Children and Families Commission (CCFC) staff has carefully reviewed the results of the audit performed by the Office of State Audits and Evaluations for fiscal year 2004/2005. We are pleased to note that the primary purpose of the audit disclosed that the revenues entrusted to this commission have been correctly and responsibly managed and reported according to California State accounting rules and regulations. I am also pleased to note that the audit found no material weaknesses involving the internal control and its operation.

I would like to address the one and only finding, which states that, CCFC monitoring of accrued expenditures, needs improvement. CCFC, in conjunction with DGS, has implemented a new reconciliation of the internal records and the CALSTARS D16 report to minimize errors and omissions in the future.

CCFC staff has always striven to meet the organizational fiscal responsibilities in the most accurate and responsible fashion and welcomed fiscal audits as an opportunity to improve methods and procedures. This audit was extremely thorough and complete, and met the anticipated benefits of continued improvement of procedures currently in place. We greatly appreciate the diligence and professionalism displayed by the audit team.

CALIFORNIA CHILDREN AND FAMILIES COMMISSION

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